In the Tax Court
Held at Johannesburg

Case IT 11282

In the matter of

“A” Appellant

and

The Commissioner for the South African Revenue Service Respondent

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Judgment

Malan J:

[1] This is an appeal against a decision of the respondent disallowing an objection by the appellant against the determination of his tax liability for the years 1990 to 1991. The appellant declared certain share dealing profits as forming part of his gross income in his tax returns and later submitted amended tax returns for the same tax years excluding the said profits on the ground that these amounts do not constitute part of his "gross income" as they were not beneficially received.

[2] The appellant gave evidence at the hearing of the matter. It appears that he was a stockbroker and a member of a stockbroking firm on the then Johannesburg Stock Exchange. In these capacities he accepted instructions from clients to buy and sell securities on their behalf and for their benefit. In other words, he acted as an agent for the benefit of his clients pursuant to a mandate given to him. His firm was entitled to the fees earned in respect of the transactions entered into for clients.

In the course of his business he acted for M and earned some R 6 million per annum as fees for his stockbroking firm. He was, so it seems, a highly successful broker.

However, during the years 1990 and 1991 he became involved in a syndicate with dealers or portfolio managers employed by M with the object of manipulating certain share transactions. Generally, the syndicate knew beforehand which shares M intended to purchase. The syndicate, with this knowledge, bought the shares in the name of an entity called “X Finance" for which an account in the appellant's stockbroking firm had been opened, "warehoused" them and thereafter resold them at a profit to M. Over these years the syndicate realised profits of about R 10 million of which the appellant's share amounted to R 233 387 and R 1 448 229 respectively.

The appellant was convicted of fraud and sentenced to imprisonment. He has, however, made full restitution of the illegal profits to M with interest in October 1992.

[3] It is clear from the evidence that the appellant, when buying shares in the market and selling them to M, acted contrary to the terms of the mandate given him by his client. His intention in entering into these transactions was to benefit the syndicate (and himself) and not M. He thus received the shares originally bought with the intention of holding them for the syndicate (and himself) and he received the profits generated after sale of the shares for his and the syndicate's benefit. What the legal effect of these transactions is will be discussed below.

[4] It is clear that income received is subject to tax notwithstanding the fact that it is tainted with illegality or is received from illegal activities. See *CIR v Delagoa Bay Cigarette* Co *Ltd* 1918 TPD 391 394; *Commissioner* of *Taxes* v G 1981 4 SA 167 (ZA) 168C-169H; *Commissioner for Inland Revenue v Insolvent Estate Botha t/a "Trio Kulture"* 1990 2 SA 548 (A) 5560-557B; ITC 1545, 54 SATC 464 (C) 474-5; ITC 1624, 59 SATC (T) 373, 377-8; *Minister* of *Finance v Smith* 1927 AC 193, 197-8; *Mann* v *Nash (Inspector* of *Taxes)* 1932 1 KB 752 757-8;

Partridge v Mallandaine (1886) 18 QBD 276; S *Southern (Inspector* of *Taxes) v* AB 1933 1 KB 713 718-9. This, however, is not the issue in this case. The question to be determined is whether the receipt of secret profits by an agent falls within the "gross income" of the agent. I accept that illegally earned income can be taxable.

[5] In *Commissioner* of *Taxes v* G 1981 4 SA 167 (ZA) 169H-170A the word "received" was construed as follows:

"I can see no warrant on the face of the statute for construing the word 'received' in any but its ordinary meaning. To extend it to cover a unilateral taking such as theft, which in any event confers no right upon the taker to the things taken, would be to give the word a meaning that could not be justified on any rational construction of the Act as a whole. In short a thief takes, he does not receive, and that is what the respondent in this case did."

On the facts of this case there was no "taking" as set out in this judgment: the appellant received the proceeds of the sales as well as original shares. His act was not a unilateral act as in G's *case.* It is therefore not necessary to consider the criticism of this case by, *inter alia,* Williams *Income Tax in* South *Africa:* Cases *and Materials* (1994) at 49. On the evidence the syndicate and its members intended to "receive" the profits for themselves. However, as I will show, this intention will be disregarded.

[6] The word "received", however, has a further qualification. In *Commissioner for Inland Revenue v Genn* & Co *(Pty) Ltd* 1955 3 SA 293 (A) it was held that not every obtaining of physical control over money or money's worth constituted a receipt for the purposes of the definition of "gross income". The court said (at 301 B-G):

"It is difficult to see how money obtained as a loan can, even for the purposes of the wide definition of 'gross income', be part of the income of the borrower, any more than the value of a tractor which a farmer borrows is to be regarded as being income received otherwise than in cash. Neither in the case of the borrowed or hired tractor nor in the case of the borrowed or 'hired' money does it seem to accord with ordinary usage to treat what is borrowed or hired as a receipt within the meaning of the definition of 'gross income'. ... It is certainly not every

obtaining of physical control over money or money's worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income. At the same moment that the borrower is given possession he falls under an obligation to repay. What is borrowed does not become his. except in the sense ... that what is borrowed is consumable. There is in law a change of ownership in the actual things borrowed" (own emphasis).

This is made clear by *Geldenhuys v Commisioner for Inland Revenue* 1947(3) SA 256(C) where "received by" was construed to mean "received by the taxpayer on his own behalf and for his own benefit" (at 260 per Steyn J). At 269 Herbstein AJ said:

"Technically it may be said that if the purchase price is paid to him it is 'received by him'. But, in my opinion, the expression 'received by him' means that the money must be received by him in such circumstances that he becomes entitled to it" (own emphasis).

[Approved in ITC 1545; 54 SATC 464 (C) at 474 and see the discussion in *Silke on South African Income Tax Volume* 1 (1995 ff)) by De Koker at par 2-5; *CIR* v *Cape Consumers (Pty) Ltd* 1999 4 SA 1213 (C) 1223AI].

In *Secretary for Inland Revenue* v *Smant* 1973 1 SA 754 (A) at 764 BC it was remarked: "The position is, therefore, that the latter payments... never accrued to the taxpayer, and he was antecedently obliged to transmit them to Plank if he received them from Media, and *he did not receive them for his own benefit.* In the result they never formed part of his gross income, and are not taxable" (own emphasis).

In order for there to be a "receipt" the money must be "received" by the taxpayer for his own benefit. In this matter the subjective intention of the syndicate and the appellant was to receive the secret profits for themselves. This, however, does not mean that, legally, they have "received" the profits for their own benefit. To understand the distinction an examination of the law of agency is required.

[7] In *Robinson v Randfontein Estates Gold Mining* Co *Ltd* 1921 AD 168 at 179-180 the classic formulation of an agent's duty is found:

"Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his interests conflict with his duty. The principle underlies an extensive field of legal relationship. A guardian to his ward, a solicitor to his client, an agent to his principal, afford examples of persons occupying such a position. ... It [this doctrine] prevents an agent from properly entering into any transaction which would cause his interests and his duty to clash. If employed to buy; he cannot sell his own property; if employed to sell, he cannot buy his own property; nor can he make any profit from his agency save at the agreed remuneration; all such profit belongs not to him, but to his principal. There is only one way by which such transactions can be validated, and that is by the free consent of the principal following upon a full disclosure by the agent. ... The general doctrine is clear enough; but the remedies available to a principal who discovers that he has purchased his agent's own property depend upon considerations of some nicety. Obviously he is not bound by the contract unless he chooses; he may elect therefore either to repudiate or confirm it. But, if he wishes it to stand and also claims the resulting profit, he must show that such profit arises from transactions completely covered by the prohibitive operation of the relationship."

[This principle has been followed over decades and has as recently as 2004 been confirmed in *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004(3) SA 465 (SCA) 478H-9C].

This principle of law "rests upon the broad doctrine that a man, who stands in a position of trust towards another, cannot, in matters affected by that position, advance his own interests (e.g. by making a profit) at that other's expense. An examination of what is involved in the remedy explains its principle. The director, in the case assumed, intends to acquire the property for himself alone; he has no idea of acquiring the equitable ownership for the company. No such *animus* enters into the transaction. His sole object is to secure the *dominium* in order to re-sell to the company at a profit. But the law refuses to give effect to that intention; it treats the acquisition as one made in the interests of the company. That can only be because it was the duty of the director to acquire the property for the company, if he acquired it at all. Its acquisition for himself would, under the circumstances, be a breach of faith which the courts will not allow him to set up" (*Robinson's case* at 179-180; own emphasis).

Following this exposition the shares originally acquired by the syndicate belonged, not to it but to its principal, M. This is so because the law does not

give effect to the subjective intention of the syndicate and the agent to appropriate the shares or profits but deems the agent to have received them for and on behalf of the principal. This follows from *Robinson's case* but has also been stated in earlier decisions such as *Transvaal Cold Storage* Co *Ltd* v *Palmer* 1904 TS 4 20-1 and 33-4 where at 20 it was said:

"I should here like to quote two passages - one from the *Encyclopedia of the Law of England* (vol 10 P 355): 'Whenever an agent in the course or by means of the agency acquires any profit or benefit without the consent of the principal, such profit or benefit is deemed to be received for the principal's use, and the amount must be accounted for and paid over to the principal.' The other is from Story *Equity Jurisprudence* (sec. 329(a)): 'Where one sustains any such fiduciary obligation to another, that such other is fairly entitled to his advice and services, either for the joint benefit of the two, or the exclusive benefit of himself; and the party sustaining such relation, in violation of his obligations and duty, enters into any subsidiary contract, with a view to his own advantage, all profits resulting belong to the party for whose benefit he ought have acted.' These passages seem to me to contain an accurate statement of the law applicable to the present dispute."

This statement was accepted by Streicher JA in *Phillips' case* at 485G-486B where he said that the appellant in that case is "deemed to have acquired the shares on behalf of the respondent and is obliged to account to the respondents in respect thereof" (par [11] at 486 B (own emphasis) and see also Heher JA par [35] at 482EF as well as *Jones* v *West Rand Extension Gold Mining* Co *Ltd* 1904 TH 325 at 335).

It follows that by law neither the shares originally bought nor the profits realised belonged to the syndicate or the appellant and were never received by it or the appellant in its or his own right or for its or his benefit but by the principal, M. (For further illustrations of this principle, see *West Coast and Rand Native Labour Agency Ltd* v *Abernethy* 1908 EDC 174; *Davies* v *Donald* 1923 CPD 295; *Union Government (Minister of Defence)* v *Chappell* 1917 CPD 265; *Herzfelder* v *Mc Arthur Atkins* & Co *Ltd* 1908 TS 332; *De Jager* v *Olifants Ftn "B" Syndicate* 1912 AD 505; *Cowling* v *Stableford* & Co 22 SC 363; *Uni-Erections* v *Continental Engineering* Co *Ltd* 1981 (1) SA 240 (W) and *Minister of Finance and Another* v *Law Society Transvaal* 1991 4 SA 544 (A)).

The appeal should therefore succeed.

The following order is given:

(1) the appeal is upheld;
(2) the profits of R 233 387 and R 1 448 229 received by the appellant during the 1990 and 1991 tax years do not fall within his "gross income" for those years.

On behalf of Mr W B Cronje (Accounting Member) and Mr GM Negota (Commercial Member) and myself

Malan J
FR Malan - President

Counsel for appellant: Mr Alan Lewis instructed by Price Waterhouse Coopers
Counsel for respondent: Mr R Tsele
Date of hearing: 28 February 2005
Date of judgment: 18/03/05
[Reportable]